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DEPARTMENT OF THE AIR FORCE
HEADQUARTERS UNITED STATES AIR FORCE
WASHINGTON 25, D. C.

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REPLY TO:

Auditor General
Comptroller, USAF
Eastern District
Liaison Office
P.O. 8155, S.W. Station
Washington, D. C.

7 May 1959

SUBJECT: Advisory Report of Subcontractor's Revised Proposal
General Electric Company
Philadelphia, Pennsylvania
Subcontractor to Lockheed Aircraft Corporation
Missiles and Space Division
Palo Alto, California
CPFF Purchase Orders Nos. 18-418 and 100-8
Under Prime Contract No. AF33(600)-37230 (RT-100)

TO : Contracting Officer

1. Purpose of Review: In accordance with verbal request a review has been made of the Contractor's revised total cost estimate of \$5,053,000 for (white) P.O. No. 18-418 and \$4,803,200 for (black) P.O. No. 100-8. These amounts include increases of \$1,103,100 and \$1,161,900 respectively above the original proposals. Accordingly, our examination included:

- a. An evaluation of the Contractor's budgetary controls over contract expenditures.
- b. A determination as to the adequacy of the revised estimate.
- c. A review of the equity of the Contractor's segregation of costs between the two purchase orders.
- d. A determination of the reliability of the monthly "Management Information Reports" submitted to the prime Contractor.

2. Results of Review:

a. Budgetary Controls - As of 1 February 1959, the Contractor has incorporated in a weekly progress report, detailed analyses of actual expenditures vs. the budgeted costs contemplated by the Contractor's revised estimate of February 1959. Such analyses are in the form of charts and graphs as well as narrative comments, indicating weekly comparisons of costs incurred with the estimates. Additional controls, providing data in greater detail were established in March 1959 and again in April 1959 in a continuing effort to pin-point deviations from the estimate. By

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these methods the contractor is able to detect promptly any significant deviations from the estimated rate of expenditures and to determine the area of the operation responsible for the deviation.

b. Adequacy of Revised Estimate - Although the Contractor has established firm controls over its expenditures, a possible additional overrun during the balance of the contract period is not precluded. A review of labor costs from 1 February 1959 (the date of the revised estimate) through 19 April 1959 indicates that while deliveries are proceeding on schedule, combined labor costs for the two purchase orders are being incurred at a slightly greater rate than that contemplated by the revised estimate. The following tabulation indicates actual labor and overhead expenditures as compared with the estimate through 19 April 1959:

	Labor and Overhead From 1 February 1959 to 19 April 1959		
	<u>Approximate Expenditures Contemplated</u>	<u>Actual Expenditures</u>	<u>Actual Over (Under)</u>
Direct Labor			
P.O. 18-418 (white)	\$183,000	\$234,000	\$ 51,000
P.O. 100-8 (black)	219,000	183,000	(36,000)
	<u>\$402,000</u>	<u>\$417,000</u>	<u>\$ 15,000</u>
Overhead 145%	<u>583,000</u>	<u>605,000</u>	<u>22,000</u>
	<u>\$985,000</u>	<u>\$1,022,000</u>	<u>\$ 37,000</u>

Similarly, a review of material requirements at 1 April 1959 indicates that approximately \$645,000 is still required, while only \$622,000 is available based on the February estimate.

c. Segregation of Costs Between P.O. No. 18-418 and P.O. No. 100-8 - In the absence of clarification by the terms of the separate purchase orders, the Contractor has established criteria by which each subcontract is to receive a share of the costs incurred under the program. While it is recognized that no precise contractual interpretation has been established as to the segregation of costs, in our opinion the criteria established by the Contractor do not necessarily adhere to generally accepted principles of cost accounting. Moreover, because of the similarity of work under the two purchase orders, operating personnel are not always cognizant of the proper contract charge. Accordingly, we believe that any determination of costs as between the two purchase orders is relatively meaningless at this time.

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However, a reasonable segregation could probably be established at the completion of both programs when all costs are known.

d. Contractor's Monthly Management Report - A review of the contractor's management report for March 1959 as submitted to the prime contractor indicates that amounts representing incurred costs are reliable, based on the books of the Contractor. However, it is noted that the "Estimate to Complete" portion of this report merely represents the difference between the revised estimate of February 1959 and costs actually incurred to date. Therefore it is the opinion of the auditor that strict reliance should not be placed on these estimated amounts.

3. Conclusions: Based on the review made, we believe that the Contractor has developed adequate procedures to facilitate continual and timely comparisons of actual expenditures with budgeted expenditures and to determine the areas of variance. Nevertheless, available data indicates that combined expenditures for the two purchase orders through 19 April 1959 are proceeding at a rate slightly above that contemplated in the revised February estimate. Consequently extreme economies will have to be effected during the remaining portion of the contract to enable completion within the estimated combined funds.

As to the separation of costs between Purchase Order Nos. 18-418 and 100-8, it appears that such determinations have generally been arbitrary both in estimating as well as in the recording of actual charges. While a reasonable accounting determination may be feasible at the completion of both purchase orders, it should be recognized that such a segregation may significantly overrun one purchase order while underrunning the other.

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